

DEPARTMENT OF COMMERCE

International Trade Administration

**Proposed Policies Regarding the Conduct of Changed Circumstance Reviews of the
Countervailing Duty Order on Softwood Lumber From Canada (C 122 839)**

AGENCY: Import Administration, International Trade Administration, Department of
Commerce

ACTION: Policy Bulletin; request for comments.

SUMMARY: The purpose of this policy bulletin is, consistent with the intent of U.S. law, to provide an incentive for Canadian provinces to move to market-based systems of timber sales that ensure that the provinces receive adequate remuneration for sales of standing timber. The proposed policies are intended to serve as the basis for a long-term, durable solution to the ongoing dispute between the United States and Canada over trade in softwood lumber and encourage the development of an integrated market for forest products consistent with the goals of the North American Free Trade Agreement and sustainable forestry.

DATES: To be assured of consideration, written comments must be received not later than July 25, 2003. Rebuttal comments must be received not later than August 8, 2003.

ADDRESS: A signed original and six copies of each set of comments, including reasons for any recommendation, along with a cover letter identifying the commenter's name and address, should be submitted to Grant D. Aldonas, Under Secretary for International Trade, Central

Records Unit, Room 1870, U.S. Department of Commerce, Pennsylvania Avenue and 14th Street, NW, Washington, DC 20230; Attention: Softwood Lumber Policy Bulletin.

FOR FURTHER INFORMATION CONTACT: Jim Terpstra, Office of AD/CVD

Enforcement, Import Administration, International Trade Administration, U.S. Department of Commerce, at (202) 482-3965.

Request for Comment

The Department solicits comments pertaining to its proposed policies on softwood lumber from Canada. Initial comments should be received by the Under Secretary not later than July 25, 2003. Any rebuttals to the initial comments should be received by the Under Secretary not later than August 8, 2003. Commenters should file a signed original and six copies of each set of initial and rebuttal comments. All comments will be available for public inspection and photocopying in the Import Administration's Central Records Unit, Room B-099, between the hours of 8:30 am and 5:00 pm on business days.

Each person submitting a comment should include the commenter's name and address, and give reasons for any recommendations. To facilitate their consideration by the Department, initial and rebuttal comments regarding these proposed policies should be submitted in the following format: (1) number each comment in accordance with the paragraph numbering of the proposed policy being addressed; (2) begin each comment on a separate page; (3) provide a brief summary of the comment (a maximum of three sentences) and label this section "Summary of the Comment;" and (4) concisely state the issue identified and discussed in the comment and provide reasons for any recommendation.

In order to ensure timely and complete distribution of comments, the Department recommends the submission of initial and rebuttal comments in electronic form to accompany the required paper copies. Comments filed in electronic form should be submitted on a DOS formatted 3.5" diskette, Iomega Zip disk, or Compact Disc (CD-R or CD-RW). Please submit each comment as a separate file on the electronic media and name each separate file using the paragraph numbering of the proposed policy being addressed in the comment. Comments received in electronic form will be made available to the public in Portable Document Format (PDF) on the Internet at the IA web site at the following address: "http://ia.ita.doc.gov/".

Any questions concerning file formatting, document conversion, access on the Internet, or other electronic filing issues should be addressed to Andrew Lee Beller, Import Administration Webmaster, at (202) 482-0866, email address webmaster_support@ita.doc.gov.

Date: _____

Signature: _____

Joseph Spetrini

Acting Assistant Secretary for Import Administration

POLICY BULLETIN

Policies Regarding the Conduct of Changed Circumstance Reviews of the Countervailing Duty Order on Softwood Lumber from Canada

Table of Contents

Purpose of the Policy Bulletin

General Statement of Policy

I. Standard for a Market-Based Timber Sales System

A. Policies and Practices That Inhibit Market Response

1. Appurtenancy Requirements
2. Minimum Cut Requirements
3. Mill Closure Restrictions
4. Minimum Processing Requirements
5. Long-term, Non-Transferrable Tenure
6. Offsetting Provincial Actions

B. Market-Based Pricing

1. Reference Prices

- a. Number of Participants in the Reference Market
- b. Quality of Information
- c. Direction of the Causal Link
- d. Barriers to Entry or Exit in the Market
- e. Safeguards Against Collusive Behavior

2. Transparency

- a. Transparency in the Functioning of the Market
Used as a Reference Point for Market Prices
- b. Application of Prices Observed in
Independently Functioning Markets to Stumpage
Set on the Administered Portion of a Province's
Harvest
- c. Comparability of Obligations Imposed
on the Purchaser

II. Examples of Market-Based Timber Sales

A. Auctions of Provincial Timber

1. Example of Auction Sales
2. Analysis

B. Comparison with Prices Established in Markets in Other Jurisdictions

1. Example of Prices Established in Markets
in Other Jurisdictions
2. Analysis

C. Other Timber Sales Methods Designed to Achieve Adequate Remuneration

III. Changed Circumstances Reviews

- A. Timing
- B. Content of Request
- C. Evidentiary Standard
- D. Conduct of the Review
- E. Effective Date of Revocation

PURPOSE OF THE POLICY BULLETIN

A government may confer a benefit on an industry by virtue of the provision of goods or services for “less than adequate remuneration.” Section 771(5)(E)(iv) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(5)(E)(iv). The term “adequate remuneration” is not defined in the statute. The Department interprets the term “adequate remuneration,” as used in section 771(5)(E)(iv), to mean fair market value. The government provision of goods or services at or above fair market value, therefore, does not provide a countervailable subsidy.

Softwood lumber from Canada is, with certain exceptions, currently subject to countervailing duties, based on the Department’s determination that the Canadian provinces provided their lumber producers with a subsidy by selling timber from provincial lands for less than “adequate remuneration,” i.e., for less than fair market value. The purpose of this policy bulletin is, consistent with the intent of U.S. law, to provide an incentive for Canadian provinces to move to market-based systems of timber sales that ensure that the provinces receive adequate remuneration for their sales of standing timber to Canadian producers of softwood lumber.

More broadly, the Department intends the policy guidance to serve as the basis for a long-term, durable solution to the ongoing dispute between the United States and Canada over trade in softwood lumber and encourage the development of an integrated market for forest products consistent with the goals of the North American Free Trade Agreement and sustainable forestry. The Department is publishing this policy bulletin with the goal that firms in Canada are free from government restraints that inhibit their ability to respond to changing conditions in the markets in which they operate and pay market prices for their timber.

The overriding objective is to create economic conditions under which lumber producers and timber markets throughout North America would face the same competitive pressures. The Department expects that reforms introduced by the Canadian provinces, consistent with the discussion below, will result in a North American market in which lumber producers and timber markets in Canada and the United States operate under similar competitive conditions and that timber valuations would equilibrate, subject to the normal qualifications based on geography, species, and other factors that normally apply in the case of timber markets in either country.

GENERAL STATEMENT OF POLICY

Upon submission of an application by a provincial government that satisfies the criteria for initiation, the Department will conduct a changed circumstances review of the countervailing

duty order on certain softwood lumber from Canada (“countervailing duty order”)¹ to determine whether reforms to the province’s system of timber sales meet the standards set out in this policy bulletin for a market-based timber sales system that charges adequate remuneration.² If those standards are met, the Department will determine that the provincial system does not provide a countervailable subsidy and will revoke the countervailing duty order with respect to lumber produced in that province.³

¹ Amended Final Affirmative Countervailing Duty Determination and Countervailing Duty Order: Certain Softwood Lumber Products from Canada, 67 FR 37,775 (May 30, 2002).

² Solely for the purpose of such changed circumstances reviews, the policies set forth in this bulletin supercede any prior guidelines, analytical frameworks or draft policies for assessing whether a provincial timber sales system is market-based and, therefore, does not provide a countervailable subsidy. The calculation of an *ad valorem* subsidy rate from provincial stumpage programs in an administrative review or other type of proceeding is governed by the Department’s regulations at 19 C.F.R. section 351.511.

³ Revocation is also contingent on the absence of any other countervailable subsidies (above *de minimis* in the aggregate), whether such subsidies are new or preexisting.

IV. Standard for a Market-Based Timber Sales System

To be considered “market-based,” a province must implement changes in its current timber sales programs that -- (1) eliminate practices and policies that inhibit the ability of lumber producers to respond to changes in the market; and (2) ensure that the pricing of standing timber on provincial lands is set by reference to prices established in an open and competitive, independently functioning market for sales of standing timber or logs. Open and competitive, independently functioning markets, as discussed below, are based on buyers and sellers participating unencumbered by artificial constraints that are part of existing administered systems.

A. Policies and Practices That Inhibit Market Response

In order to move toward a market-based system of timber sales and ensure that a province receives adequate remuneration for its sales of standing timber, it is essential that the price for standing timber be set with reference to prices established in independently functioning markets. Just as important, however, are any government practices that limit the operation of market forces and interfere with an industry participant’s ability to respond freely to changes in the marketplace. Functioning markets rely on industry participants to respond to market signals free of artificial constraint.

Accordingly, as part of any changed circumstances review, the Department will determine whether individual provinces have, in fact, eliminated or substantially reformed the policies and practices identified below in a way that removes the current constraints on a lumber producer’s ability to respond to changes in the market and, thereby, reinforces the operation of market forces.

1. Appurtenancy Requirements

Appurtenancy and similar provisions mandate that the tenure holder process timber harvested under the tenures in specific mills or mills they own, which limits the ability of tenure holders to rationalize their harvesting operations, log purchase and sale operations, and lumber production in response to changing market conditions.

2. Minimum Cut Requirements

Perhaps the most extreme interference with market forces is in the operation of minimum cut requirements. These requirements, which can be either explicit or implicit, are currently imposed on or perceived by tenure holders to apply to provincial forest land and oblige tenure holders to cut a certain volume of timber during a set period regardless of conditions in downstream product markets that drive the actual demand for timber on the stump. These requirements can be explicitly provided for in provincial regulations or imposed implicitly through the means by which the province implements its policies with respect to the annual

allowable cut under tenures and licenses. The result is either a requirement or an incentive to continue harvesting and producing lumber even when market conditions would dictate otherwise.

3. Mill Closure Restrictions

Mill closure restrictions generally dictate the number of days a mill must be in productive operation in order for the operator to maintain access to its tenure. As a result, a mill may be forced to continue to produce lumber even when market conditions would otherwise compel a cut in production or closure of the mill.

4. Minimum Processing Requirements

Minimum processing requirements require the tenure holder or timber buyer to undertake some minimum amount of processing of the timber harvested (or an equivalent volume) before it can be shipped from the province. These requirements have the effect of constraining the impact of market forces in public and private timber markets, as well as limiting the options available to the tenure holder to rationalize harvesting operations, log purchase and sale operations, and lumber production in response to changing market conditions. The elimination or reform of such requirements would reinforce the normal operation of supply and demand in any open and competitive, independently functioning market for timber sales. The Department will, as a consequence, take into account any minimum processing requirements in evaluating the market chosen by a province as a reference point for setting stumpage on provincial lands.

5. Long-term, Non-Transferable Tenure

Long-term, non-transferable tenures create barriers to entry or exit from the market for provincial timber, which limit competition for the province's timber and the ability of individual firms to adjust to changing conditions in the marketplace.

An important aspect of long-term, non-transferable tenure is the degree to which the security of supply it affords also inhibits the responsiveness of tenure holders to changes in the market. Such inhibition would serve to undermine the overall operation of market forces in the province; which in turn interferes with the market's ability to set prices. The issues may, however, be most appropriately addressed as a factor affecting the use of reference points in independently functioning markets as a basis for setting stumpage rates on the administered portion of a province's harvest. Adjustments to the observed prices may be required to take into account the differences in the attributes of sales in the independently functioning market and long-term, non-transferable arrangements on provincial lands, including the security of supply associated with a long-term, non-transferable tenures on the administered portion of a province's harvest.

6. Offsetting Provincial Actions

The Department will also examine any evidence that suggests that a province maintains or introduces other requirements or conditions on the sale of provincial timber that would inhibit or undercut the operation of the policy reforms discussed above. The Department will, for

example, want to ensure that a province's decisions with respect to the annual allowable cut authorized on provincial lands is consistent with sound forest management and the full rotational economics of the forest, rather than a means of increasing supply and thereby artificially lowering the amount charged on provincial stumpage.

B. Market-Based Pricing

By "market-based pricing," the Department means that a province sets its prices for sales of standing timber on provincial lands either through free and open competition, such as auctions of standing timber or log markets, or a system that ensures the equivalent result. In either instance, to qualify the system must ensure that a province receives adequate remuneration on all provincial timber.

1. Reference Prices

For any portion of a provincial harvest that continues to be sold under prices set administratively the Department will, in general, focus on whether those prices are set by reference to a sufficient range of representative transactions in one or more independently functioning markets for sales of standing timber or logs. Examples of independently functioning markets would include open and competitive auctions of standing timber on provincial lands, competitive log markets, robust and competitive markets for the sale of standing timber or logs harvested from private lands within the province, and, where relevant, similar markets functioning in other jurisdictions.

In assessing whether any reference market is an open, competitive, and functioning independently, the Department will not employ a presumption that a market must represent a specific percentage of the a province's harvest before it could be used as a point of reference for setting prices on the administered portion of the harvest. The Department will, instead, employ a rule of reason – one that is designed to ensure that the market used as a point of reference affords a sufficient basis to establish fair market prices that would then apply to the administered portion of the timber sales system. As reflected in the discussion below with respect to the number of market participants, all other things being equal, the greater the number of market participants who must participate in the reference market for a sizeable share of the furnish for their mills, the stronger the evidence that the reference market is open, competitive and functioning independently of the administered portion of a province's harvest, and would, as a consequence, serve as an adequate reference point for assessing stumpage on provincial lands.

One reason for adopting that approach is the potentially significant interplay between a province's willingness to undertake the tenure reforms outlined above and the percentage of its harvest that could be used as a reference point for pricing on the administered portion of the province's harvest. To the extent a province has made the reforms outlined above and tenure holders are free to respond to changes in the market, it is easier to identify and evaluate the operation of independent market forces and the size of the reference market *per se* becomes less significant in ensuring an adequate range of reliable prices that could be used to set stumpage on the administered portion of a province's harvest.

In assessing whether the market-based reference prices provide an adequate basis for setting administered prices that constitute adequate remuneration, the Department will focus on (1) whether the market(s) a province chooses to use as a point of reference (“reference market”) actually functions as a market and (2) whether that reference market functions independently of the administered portion of that province’s harvest. In determining whether the reference market in fact, “functions” as a truly competitive market, the Department will consider the number of participants, open access to the market, the volume of timber traded on the market (including imports and exports), the lack of restraints on buyers and sellers, access to market information, and other factors listed below. For the Department to determine that the market used as a reference point operates “independently,” the Department will want to assure itself, consistent with the discussion below about the direction of the causal link between the reference market and the administered portion of the harvest, that prices observed in the reference market are the result of the free operation of market forces unaffected by any distortions associated with provincial administered timber policies or the effect from stumpage rates charged on the administered portion of the harvest.

More specifically, the Department will examine, *inter alia*, the following characteristics of each reference market chosen by a province for setting the prices for standing timber on the administered portion of a province’s harvest, regardless of whether the market chosen involves auctions of the province’s own standing timber, auction sales in other jurisdictions, private sales within the province or in other jurisdictions, or any other set of market-based transactions.

a. Number of Participants in the Reference Market

The province must demonstrate that there are sufficient numbers of participants in the reference market to ensure that no individual or group of market participants can influence the sales prices. This does not mean that a small number of actual participants on any particular transaction necessarily means that the market is not functioning. Rather, the more fundamental question is whether the market is contestable (*i.e.*, anyone who wants to bid or buy and use the fiber as they choose, depending on the form of sale, has a fair and open opportunity to do so).

In addition, to the extent that many producers are able to source all, or virtually all, of their wood fiber needs from crown tenure, these parties would not be active participants in the private market. As noted above, all other things being equal, the greater the number of market participants who must participate in the reference market or other competitive markets for a sizeable share of the furnish for their mills, the stronger the evidence that the reference market is open, competitive and functioning independently of the administered portion of a province’s harvest and would, as a consequence, serve as an adequate reference point for assessing stumpage on provincial lands.

b. Quality of Information

The province must demonstrate that similar full and transparent information is available to all participants in the reference market about alternative commercial opportunities, particularly

with respect to price. This is especially important in those instances in which a province intends to rely for its reference prices on a private market that is made up largely of bilaterally negotiated sales of standing timber on private lands, but would be important to the Department's assessment of any auction-based system as well.

Thus, for example, it would be particularly important for any private owner of standing timber to have access to current information on prices others are receiving for similar stands in assessing the amount he or she intends to charge. This would help sellers (either public or private) develop a "reservation price," a price below which the seller will not sell – one that is consistent with the fully allocated costs of the seller's investment in bringing the forest to a harvestable state. For small holders, this could ensure that they receive the "market price" even if only a limited number of buyers were making bids. This information flow could take the form of internet pages, trade publications, or other similar sources of public information.

In addition, a significant feature of any independently functioning market is the availability of sufficient information about the characteristics of timber being offered for sale in such markets to all buyers such that the seller and no individual buyer has an unfair advantage. The more significant the uncertainty about the quality of the timber, the higher risk that the uncertainty will result in lower prices for the timber in such markets. As a consequence, the Department will examine whether potential buyers in the reference market have the opportunity to survey the timber or there are commercial services available that will survey the timber in order to eliminate any potential advantages that preferential access to information about a given stand might otherwise confer.

c. Direction of the Causal Link

The province must demonstrate that the prices established in the reference market are determined independently (*i.e.*, independent of any influence from distortions associated with provincial administered timber policies or the effects from pricing of stumpage on long-term tenures on provincial land). More to the point, in any attempt to translate prices established in an independently functioning market to stumpage charged on the administered portion of a province's timber, the Department will want to ensure that it is the prices found in private or otherwise independently functioning markets that is dictating the prices on the administered portion of the harvest (*i.e.*, that causality runs from auction sales or private markets to administered sales), rather than the reverse.

Thus, for example, in the case of a province that chooses to rely on a market for private timber within the province as a reference point for establishing prices on the administered portion of its harvest, the province must demonstrate that its pricing model ensures that firms or individuals with significant long term tenures cannot artificially force down prices in the private market to lower stumpage charged on the administered portion of the harvest.

d. Barriers to Entry or Exit in the Market

The province must demonstrate that there are no significant barriers to entry or exit into the reference market for either sellers (private woodlot owners, log traders, and, potentially, tenure holders) or buyers (lumber, pulp and paper mills, or other processors). Thus, for example, the Department will want to examine whether there are participation constraints that limit competition such as nationality requirements, conditions requiring that a bidder own a sawmill, or barriers to inter-provincial or international trade in private sector logs that affect the market to be used as a reference point.

e. Safeguards Against Collusive Behavior

In addition to examining the structure of the reference market for establishing the stumpage on the administered portion of its harvest, the Department must be assured that the market is free of any collusive behavior and that the province has in place adequate safeguards against such behavior. Such safeguards are particularly important when considering the design of any auction system for sales of public timber, but that is not the only environment in which such safeguards are relevant. Beyond auction design lies the consideration whether the market a province uses as a reference point on prices is protected against collusive behavior. The question is both one of law and of the enforcement activities of authorities responsible for administering the relevant jurisdiction's laws designed to ensure competition.

2. Transparency

Transparency is a key feature of both markets and sound administrative practice that the Department will examine with respect to any pricing system. The following discussion highlights three areas in which transparency will be factored into the Department's analysis of whether a timber sales system is market-based.

a. Transparency in the Functioning of the Market Used as a Reference Point for Market Prices

A factor in considering the adequacy of any reference market is the transparency with which that market operates. For example, in the case of the auction of public timber, one of the key features of the market for standing timber that such a system generates is the timely publication of the results of the auctions so that all participants in the market have adequate information on which to set expectations for succeeding bids. At the same time, publication of the results will assist in providing a verifiable set of prices in a sufficiently robust market to afford an adequate basis for setting stumpage prices on the administered portion of the province's harvest.

Similarly, in the case of log markets, adequate public information about the transactions on the market would be essential to the ability of participants in the market to rely on the results in setting expectations for future bidding on logs. The Department would need to see a similar degree of transparency in the reporting of prices on transactions in a log market to be able to assess whether the market could serve as an adequate reference point for setting stumpage rates on public lands or otherwise provide assurances of the adequacy of remuneration.

To serve as an adequate reference market, a log market must place the logs for sale on reasonable terms to any bidder and operate on price, as opposed to “swaps,” with sufficient volume moving through the market to ensure that it provides an adequate basis for setting stumpage. As reflected in the discussion above with respect to the number of market participants and entry and exit barriers, prices must result from a competitive process open to all interested buyers and sellers. In addition, the log markets must establish a way of ensuring that information about individual transactions is accurately reported and publicly available in order to inform market participants regarding the going rates for certain logs, as well as to serve as a useful reference point for setting stumpage on the public harvest.

Most private transactions for timber in Canada are conducted through a series of bilateral negotiations between buyers and sellers. While there is a good deal of information available on the going rates that certain market participants might offer or pay in the market, there is generally no systematic reporting of such transactions, through an active public exchange for example, that would ensure both a stronger market and a more reliable reference point for setting stumpage rates on the administered portion of a province’s harvest. Demonstrating transparency in such markets would provide significant confidence in the results that the market produced and, therefore, in the market’s reliability as a reference point. Transparency will also be critical in markets where previous transactions were not on a price basis, e.g., log swaps.

b. Application of Prices Observed in Independently Functioning Markets to Stumpage Set on the Administered Portion of a Province’s Harvest

The province must also demonstrate that the mechanism by which it translates the reference prices to the administered portion of the harvest is transparent. The Department can determine that a timber sales system is market-based only if the mechanism by which market references prices are applied in the administered pricing system is transparent and accurate.

In determining whether a system is transparent, the Department will consider the extent to which -- (1) the province relies on publicly available information on market prices as a starting point for setting stumpage; (2) the province collects information from private market participants in a rigorous, systematic, and verifiable manner and regularly publishes this information; (3) information on adjustments and the basis for those adjustments is publicly available; (4) the calculation involved in adjusting market prices to apply to the harvest on public lands, while taking into account the appropriate adjustments, produces an observable result consistent with the reference point in the market and is based on objective verifiable information,

including where possible market-determined costs; and (5) the results of the calculation (i.e., the resulting stumpage fees) are publicly available to all market participants so that they can serve, in some respects, as a safeguard of the stumpage system.

Adjustments should be kept to the minimum necessary, and must be fully and economically justified, and transparent so as to maintain a close and accurate link between market-determined and administered prices and avoid adjustments that might lead to the over- or under-valuation of timber.

To the extent that prices and costs in the reference market are identified and translated using surveys of private transactions, great care must be exercised in survey design. Surveys should be representative, timely, and reflective of the commercial experience of buyers, sellers, and other commercial intermediaries to ensure there is no opportunity for reporting bias. Moreover, as discussed below, the tremendous information requirements needed for accurate transmission of stumpage prices raise the need for an extensive information collection and reporting function.

Given the significant variation in stumpage prices associated with the numerous characteristics of each plot, an accurate transmission from the reference market to the administered harvest requires a significant amount of information. The Department must be satisfied that all relevant characteristics of the administered portion of the harvest are adequately accounted for in the reference market. These factors could include, among others, the biophysical characteristics of the different plots of trees subject to stumpage transactions; different harvesting conditions, and different industry characteristics (i.e., large and small producers of different types of products). Because of this, the information requirements from the reference market are quite high.

c. Comparability of Obligations Imposed on Purchaser

The terms and conditions that apply to sales of timber in reference markets are likely to be different from those that apply to the purchase of standing timber under a long-term tenure on provincial land. The use of reference markets will therefore necessarily require some adjustment for the differences in the terms and conditions applicable to the two forms of timber sales contract. Transparency in the calculation and application of those adjustments will be essential for the Department to determine that the administered pricing system properly translates the reference prices to the provincial harvest in a manner that ensures that the provinces receive adequate remuneration.

II. Examples of Market-Based Timber Sales

As noted above, market reference prices may come from a single source (e.g., competitive auctions) or multiple sources (auctions, private market transactions, within or outside the province). The Department recognizes that some provinces may choose to rely on a variety of mechanisms to facilitate the operation of market forces within the province.

Regardless of the mechanism adopted, consistent with Part I of this Policy Bulletin, market reference prices must come from open, competitive, independently functioning markets and ensure that provinces receive adequate remuneration for all provincial timber. What follows is a series of examples of how the Department would apply its policy guidance in the context of a specific market.

A. Auctions of Provincial Timber

One means of establishing a market price for standing timber as a reference price for setting stumpage would involve selling a substantial portion of a province's own timber at auction. That, combined with the elimination of the constraints currently in place on the ability of the tenure holders to respond to changing market conditions, could provide a sufficient basis for finding that the system was market-based, thereby ensuring that a province received adequate remuneration for its timber, and providing the legal basis for revocation of the outstanding order with respect to that province.

1. Example of Auction Sales

Province A eliminates existing constraints on tenure holders in the form of minimum cut requirements, appurtenancy clauses, and mill closure limitations. Province A also eliminates or reforms any minimum processing requirements in order to ensure that market forces are fully at play within the province and between the province and other jurisdictions. In addition, Province A makes its tenures freely divisible and transferable and fully subject to competition policy. In addition, Province A manages its harvest, particularly its annual allowable cut, on the basis of sound forestry and full rotational economics, rather than as a means of artificially expanding supply.

With respect to pricing, Province A implements an auction system for sales of provincial timber that ensures a sufficient volume of timber and a representative sample of transactions to permit the auction prices to serve as an open, competitive and independently functioning market and as an adequate (*i.e.*, statistically reliable) reference point for setting stumpage prices on the administered portion of the harvest. Province A manages its harvest and locates its auctions in a manner best designed to maximize participation and competition for the fiber, and introduces other reforms in its timber allocation system that have the effect of increasing the share of competitive sales progressively over time.

To encourage participation by all market participants in the auction process, Province A ensures that there are no barriers to eligibility for bidding or the use of fiber other than those necessary to ensure that the bidder can fulfill the contract. Tenure reforms undertaken by Province A ensure that a sufficient portion is sold through competitive markets, either as timber or logs, to provide the number and range of transactions necessary to extrapolate accurately from the auction sales to prices charged for stumpage on the administered portion of the harvest. Tenure reforms undertaken by Province A result in the need for all, or virtually all, market participants to, obtain a significant share of their fiber from the reference market or competitive log markets on an ongoing basis.

In terms of auction design, Province A constructs the auction on the basis of sealed bids. Province A also adopts adequate procedures to ensure against collusive bidding. Prices for all auction sales are published regularly for the benefit of all market participants. Auction winners should be required to harvest the timber within a specified period.

Province A can demonstrate that it ties its stumpage rates, accounting for any necessary adjustments, directly and accurately to the prices observed in auctions for similar stands of timber. Province A publishes stumpage charged so that the information is broadly available to all market participants.

In addition, in an effort to expand the competition for fiber throughout the province generally, Province A reinforces the operation of log markets within the province on the basis of price, rather than fiber swaps. Province A ensures that increasing amounts of fiber will flow through such log markets by virtue of eliminating the constraints on tenure that would currently prevent sales on log markets, rather than swaps. Province A ensures that information on log market transactions are broadly available to all interested market participants by establishing the means for all transactions to be recorded with the province and then made available to the public. Administered timber volumes that flow through fully open and competitive log markets, unrestricted in market participants or by minimum processing requirements, would count towards the overall portion of crown timber subject to competitive pressure and help ensure that Province A receives adequate remuneration on all timber sales.

2. Analysis

If all the conditions outlined above and those discussed elsewhere in the Policy Bulletin were met, the Department would revoke the current countervailing duty order with respect to that province. Province A would have to demonstrate that it had the two essential elements of a market-based system of timber pricing that would assure the Department that the province was receiving adequate remuneration within the meaning of the law. First, Province A would have eliminated all or virtually all of the current constraints on companies operating in the province that currently prevent them from adjusting to changing market conditions. Second, Province A would have introduced and implemented a system of auctions that were sufficient to establish market prices that could be used to set stumpage on the administered portion of its harvest, ensuring that the province received adequate remuneration on all timber sales.

More specifically, by eliminating the minimum cut requirements, mill closure limitations and appurtenancy clauses, as well as making its tenures freely divisible and transferable, Province A has ensured not only that firms are not compelled to produce when markets would otherwise dictate against it, but also removed barriers to the increased flow of fiber from tenure holders onto competitive markets, whether in the form of transfers of tenure, sales of standing timber, or sales of logs. The ability to move timber through those various forms of competitive market will also have the effect of increasing the value of those markets as indications of stronger competition for fiber within the province. As a result of these and other changes, the typical manufacturer will participate in competitive timber and log markets for a sizeable portion of their fiber requirements on an ongoing basis under all market conditions.

In addition, by eliminating any minimum processing requirements within the province, and potentially between the province and other jurisdictions, Province A has increased the ability of markets within the province to transmit information about prices and sales opportunities that the minimum processing requirements previously foreclosed. A subsidiary benefit of eliminating the minimum processing requirements and permitting purchases of the province's logs by buyers from outside the province, Province A would expand the opportunities for arbitrage between markets in different jurisdictions and thereby preclude the ability of producers in Province A to benefit from changes in provincial policies without the competitive benefit of those changes in policy flowing to competitors in other jurisdictions.

With respect to pricing, Province A will have ensured that it has a reliable point of reference in a range of market transactions that is representative of the harvest within the province. By ensuring that there are only the minimum necessary requirements to be eligible to bid on the province's timber, Province A will have eliminated one of the main barriers created by the long-term tenure system – the barrier to new entrants into the market for Province A's timber. Similarly, by introducing tenure reforms that have the effect of ensuring that virtually all market participants have to participate in the auction system or competitive log markets for a sizeable portion of their fiber, Province A will ensure that firms within the province face competitive pressures akin to those faced elsewhere in the North American market. To the extent that the tenure reforms, over time, also yield a reduction in the percentage of the harvest that is subject to long-term tenures relative to that portion of the harvest that is sold at auction or through open and competitive log markets, Province A will reinforce the competition for timber on private and Crown land as well.

By ensuring that the information on prices established at auction is broadly available to all market participants, Province A will have increased the quality of information available on alternative commercial opportunities. It will have ensured that the maximum amount of information about transactions in the market place is flowing back to market participants to inform their decision not only about future auctions, but about prices reflected in other competitive markets within the jurisdiction.

Province A will also have ensured, in the process, that the adjustments needed to translate the prices observed at auction into stumpage charged on the administered portion of the harvest accurately and solely reflect the different terms and conditions between auction sales and the administered portion of the harvest. In doing so, Province A will ensure that the stumpage charges on the administered portion of the harvest ultimately reflect the value of the fiber in an open, competitive market, which is necessary to demonstrate that the province is receiving adequate remuneration for its timber.

By reinforcing the operation of log markets within the province, even though they would not be used as a reference point for setting stumpage, Province A would have helped create an effective outlet for fiber that will become increasingly available on the market as a result of the elimination of the constraints currently imposed on tenure holders. In addition, by providing a means by which log market transactions are made publicly available to market participants,

Province A has fostered a more competitive market within the province for fiber, which would tend to reinforce the utility of the auctions as a reference point for the pricing of stumpage on the administered portion of Province A's harvest. That result would flow directly from the ability of the log markets to improve the range of alternative commercial opportunities available to market participants. To the extent that Province A improves the ability of the log markets to function by shifting licenses or tenures toward new market participants in the future, it will have the effect of expanding the competitive forces at work in the market by easing the entry of new competitors.

B. Comparison with Prices Established in Markets in Other Jurisdictions

Another alternative mechanism a province might use to ensure that it received adequate remuneration within the meaning of the statute would be to use prices generated in a market outside its jurisdiction. While taking into account the need for adjustments in order to ensure a fair comparison between standing timber sold in the two jurisdictions, prices generated in auctions from public lands or private markets, for example, could serve as an adequate reference point for setting stumpage on the administered portion of a province's harvest, if combined with adequate policy reforms in other areas of the province's timber sales program.

1. Example of Prices Established in Markets in Other Jurisdiction(s)

Province B eliminates any existing minimum cut, mill closure, appurtenancy, and minimum processing requirements. Province B also provides for the divisibility and free transfer of tenure. Province B manages its harvest, particularly its annual allowable cut, on the basis of sustainable forestry, rather than as a means of artificially expanding supply.

Province B relies on prices from the sale of standing timber in open, competitive markets in an adjacent jurisdiction, or jurisdictions, to establish the reference point for setting stumpage on the administered portion of its harvest. The independently functioning markets for standing timber in the other jurisdiction, or jurisdictions, have no barriers to entry or exit, provide for the publication of price information to all market participants, include appropriate safeguards against collusive bidding, and provide a representative range of prices for standing timber comparable to that sold in Province B.

In addition, Province B reinforces the operation of the private market for standing timber within the province through the changes in conditions applicable to tenures on provincial lands. Province B also develops a mechanism for gathering and publishing the information on pricing in that private market, which is currently characterized by a series of bilateral negotiations between buyers and sellers. Province B commits not to reduce the share of competitive sales and should increase the share of competitive sales progressively over time.

Province B ensures that it adopts a transparent means, with the appropriate adjustments, to translate the prices established by open, competitive, and independently functioning markets in the adjacent jurisdiction into stumpage charged on the administered portion of Province B's harvest.

2. Analysis

By eliminating those conditions that prevent companies from adjusting to changes in the market, in the form of minimum cut, mill closure limitations, appurtenancy clauses, and minimum processing requirements, Province B ensures that firms participating in its market can respond appropriately to market signals from downstream product markets. Firms would be free to adjust their production accordingly.

Similarly, by providing for the divisibility and transferability of tenure, Province B encourages competition for timber within the province. In effect, Province B has eliminated the principal barrier to entry or exit from the market for standing timber within the province. It also ensures that a greater volume of timber or logs will enter the private market for fiber within the province.

By linking its stumpage system to open and competitive markets in an adjacent jurisdiction that satisfies the criteria outlined in the example, Province B also ensures that it has a reference point in an independently functioning market to use in setting stumpage on the administered portion of its harvest. Province B has thus adopted a reference point that ensures that it receives adequate remuneration for its timber. Any adjustments should be kept to the minimum necessary, and must be fully and economically justified, and transparent so as to maintain a clear and observable relationship between market-determined and administered prices.

The province's efforts to strengthen its private market are intended to address the reference points it might use to set stumpage at a later date. In the interim, Province B's efforts in that regard will also serve to improve the functioning of the market within the province by lowering barriers to entry into the market by new market participants. It also ensures a more competitive market for additional fiber that may flow through the private market as a result of changes in the conditions applicable to tenures on provincial land by providing all market participants with information regarding alternative commercial opportunities. While not directly relevant to the question of whether Province B has made those changes necessary to pursue a changed circumstances review, the effort to strengthen the private market does serve to increase the confidence the Department may have in the operation of the province's stumpage system and its ability to ensure that Province B receives adequate remuneration for its timber.

The key issue for Province B under the facts set out in the example is likely to be the transparency it can introduce into the means by which it translates prices from auctions of standing timber in the adjacent jurisdiction to stumpage charged for comparable sales of timber on the administered portion of the province's harvest. It will be essential for Province B to establish the validity of the mechanism or calculation it uses in translating the prices from the adjacent jurisdiction to Province B's harvest – it must be transparent in the sense that it is publicly available and that the potential adjustments are known and appropriate to the task.

Equally important, it will be essential that the province make the results of both its methodology and the stumpage charged on sales of standing timber available to all market participants. Market price signals are the key means for distilling information about market

conditions and the province must ensure that, consistent with the other changes it has made to eliminate constraints on the ability of firms to adjust to market conditions, the province has made available the key information that should guide firms in making those adjustments.

Under the circumstances outlined above, the Department would revoke the countervailing duty order with respect to imports of softwood lumber manufactured from the timber harvested in Province B.

C. Other Timber Sales Methods Designed to Achieve Adequate Remuneration

The Department acknowledges that there may be market circumstances unique to a province such that the provincially administered portion of the harvest constitutes the vast majority of available supply and the provincial forest industry is dominated by a single integrated forestry firm. In such circumstances it would be difficult to establish an independently functioning market, either in the form of auction of crown timber or reliance in private sales, in the province. Moreover, the bio-physical characteristics of the forest resource, and its remote location, render the use of independently functioning markets in other jurisdictions highly problematic due to the magnitude of necessary adjustments.

Where such unique circumstances exist, the Department will examine whether the province's means of setting stumpage on the administered portion of its harvest achieves the equivalent economic effects of the alternatives set out above and ensures that the province receives adequate remuneration. Such an alternative would have to be independently evaluated based on its merits. Where, however, a province eliminated the conditions imposed on tenures as outlined in the discuss in Part I above, and implemented a method of timber valuation that afforded the province adequate remuneration with in the meaning of the statute, the Department would, consistent with the conditions outlined above and discussed elsewhere in the Policy Bulletin, revoke the current countervailing duty order with respect to that province.

III. Changed Circumstances Review

A. Timing

A Province may submit a request for a changed circumstances review at any time. Prior to filing such a request, at the request of a province, the Department will consult with the province over the contents of such a request.

B. Content of Request

The Department will initiate a changed circumstances review upon receipt of an application containing the following information:

1. Appropriate documentation (e.g., laws, regulations) demonstrating elimination of any policies and practices that inhibit market response, as defined in section A.1, above; and
2. A detailed explanation of the design and operation of the market-based provincial timber pricing system with supporting documentation and data showing that system meets the standards set forth in this policy bulletin.
3. Consistent with the examples set out above, evidence that provinces submit in support of their request for review should include, as appropriate –

- Evidence that the conditions a province currently imposes on tenures set out in Part I have been eliminated or reformed, as a matter of law, and that such changes in the conditions have been fully implemented in the timber sales program;
- Evidence that demonstrates that the reference markets a province chooses to use for purposes of setting stumpage on the administered portion of its harvest operates in a manner that is open and competitive, particularly with respect to the number of market participants, the volume of timber sold through the reference market, ease of entry and exit by market participants, the quality of information available to market participants, barriers to individuals or firms artificially lowering prices in the reference market as a means of lowering stumpage charged on the administered portion of the harvest, and the transparency of the operation of the market;
- Evidence that demonstrates how the prices observed in the reference market are accurately and transparently translated to the stumpage charged on the administered portion of the harvest consistent with the examples set out above, particularly with respect to any adjustments made between the timber sold in the reference market and that sold on the administered portion of provincial lands; and
- Evidence regarding stumpage charges on the administered portion of the harvest before and after the provincial reforms are implemented that reflects the impact of the changes on stumpage prices and evidence that demonstrates that stumpage charged on the administered portion of the harvest is consistent with the range of prices observed in other open and competitive markets for timber sales of similar species, quality, and market conditions.
- Any other relevant evidence concerning the operation of the provincial timber sales system.

Although the Department may issue supplemental requests for information, the application should, to the fullest extent possible, contain all of the information necessary to determine whether the provincial timber sales system is market-based so that the Department may determine whether there is evidence of changed circumstances sufficient to warrant a review.

C. Evidentiary Standard

The Department has made a final determination that the Canadian provinces provide a subsidy to lumber producers by selling timber for less than adequate remuneration. In a changed circumstances review, the burden is on the province to establish that those circumstances have changed such that revocation of the order with respect to that province is warranted. Specifically, the province must establish the basis for revocation through substantial, verifiable evidence demonstrating, in accordance with this Policy Bulletin and as required by U.S. law, that the provincial timber sales system

has been revised and is operating so as to ensure that the province receives adequate remuneration within the meaning of the U.S. countervailing duty law.

D. Conduct of the Review

The Department will conduct the Changed Circumstances Review in accordance with sections 351.216 and 351.221 of the Department's regulations. Pursuant to those regulations, the Department will, within 270 days, issue a final results of review. The Department may issue requests for information and will verify information submitted in the application and any responses to requests for additional information. The Department will, upon request by an interested party, hold a public hearing, pursuant to 19 C.F.R. § 351.310.

E. Effective Date of Revocation

As reflected in section III.B, the Department anticipates that, on the date the application for the changed circumstance review is filed ("application date"), the reforms of the provincial timber sales system will be in place and operating so as to ensure that the province receives adequate remuneration. Accordingly, if the Department determines, as a result of the review, that revocation of the order with respect to the province is warranted, the Department will normally order revocation of the countervailing duty order with respect to all unliquidated entries of the subject merchandise produced in the province from timber harvested in the province that is entered, or withdrawn from warehouse, on or after the application date. If, however, reforms necessary to demonstrate a market-based timber sales program are not in effect or operational at the time of a province's application date, the Department may alter the effective date of the revocation to reflect the date on which such reforms took effect during the period of the changed circumstance review.